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SEPTEMBER 7, 1992
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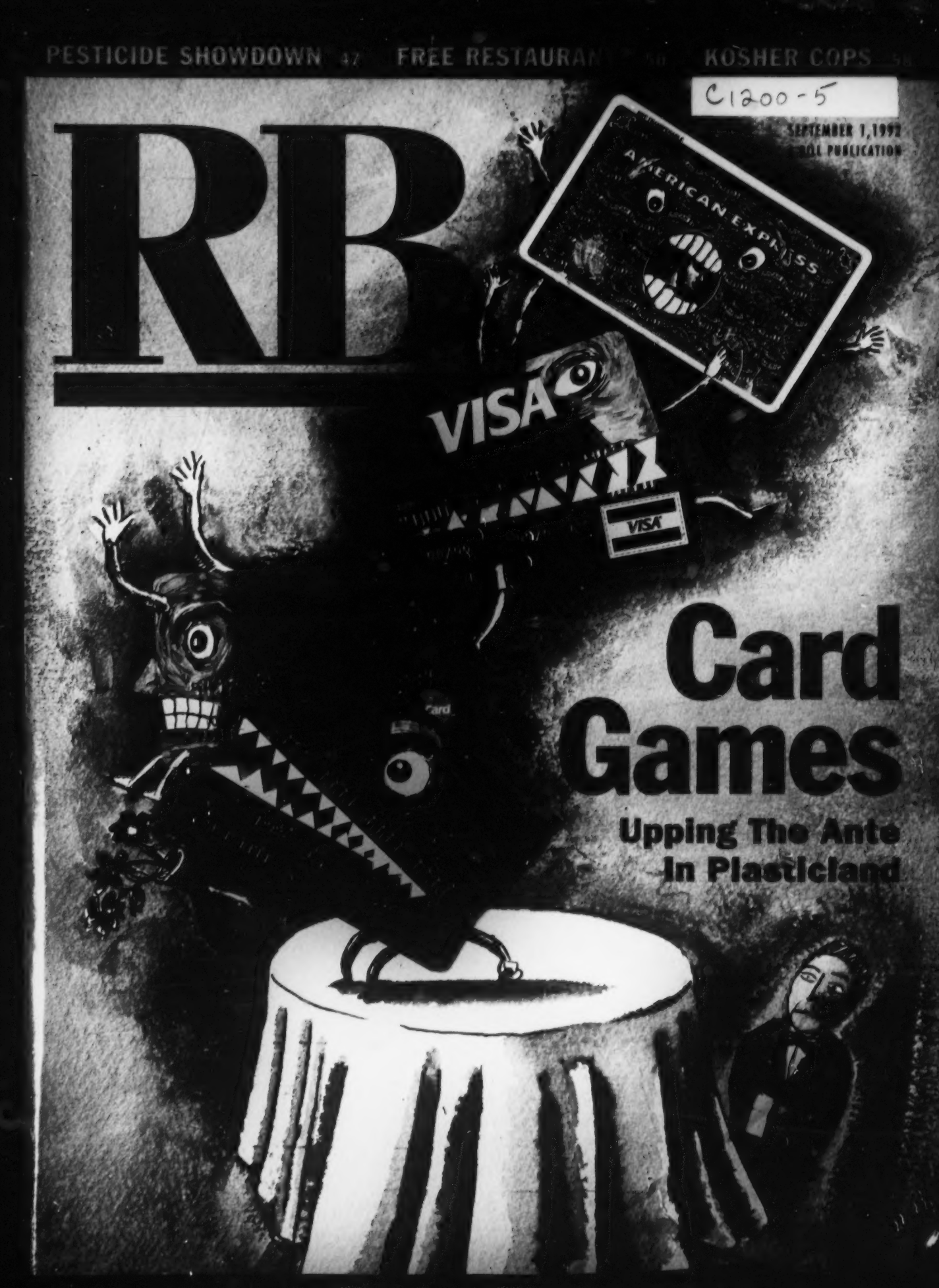


Card Games

Upping The Ante In Plasticland

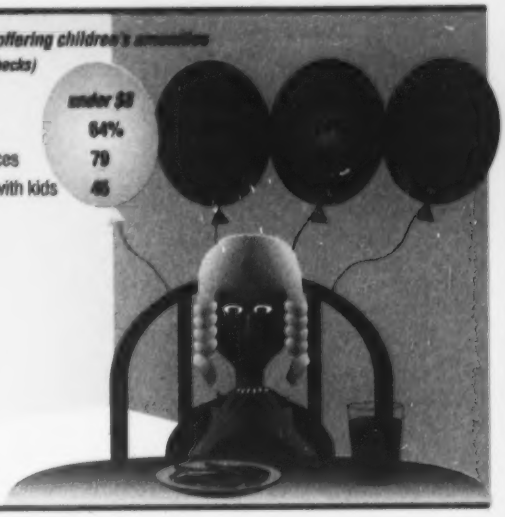
BUSINESS BAROMETER

Child-Friendly Restaurants: More Than You May Think

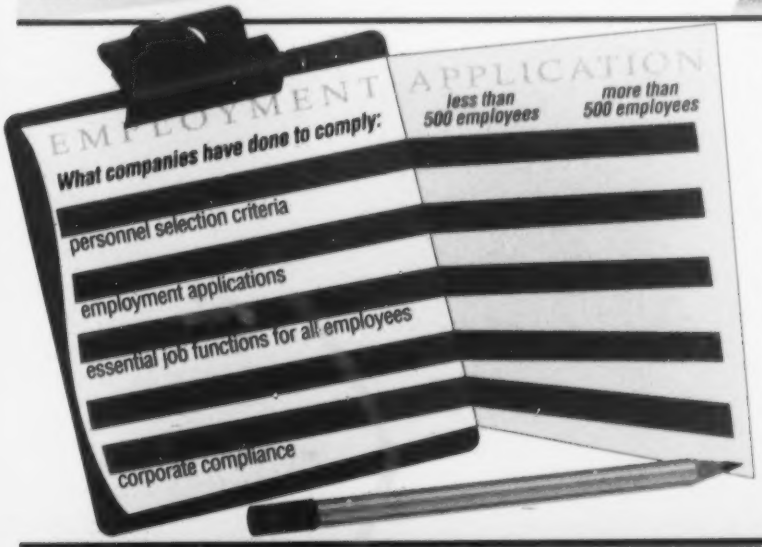
Restaurants are clearly catering to parties with children: the number of children's entrees on tableservice menus has doubled over the past five years, from 3% of the total entree mix in 1986 to 6% in 1991. Operators needn't do anything extravagant to please them. Kids favorite foods: french fries, pizza, and hamburgers.

% of tableservice restaurants offering children's amenities (categories by per-person dinner checks)

	under $8
Children's favorite menu items	64%
Child-size portions at lower prices	79
Promotions to attract families with kids	45



Source: National Restaurant Association



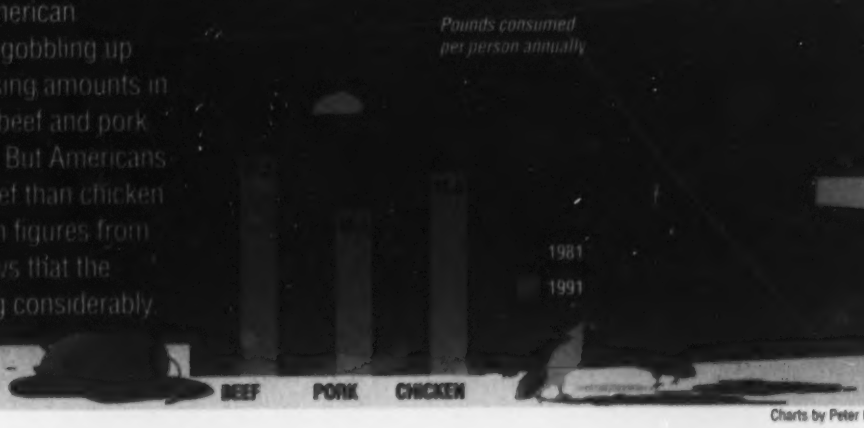
Coping With The ADA: What Have Companies Done?

Title 1 of the Americans With Disabilities Act—involving prohibitions on employment discrimination—went into effect July 26 for those with 25 or more employees, sending restaurant operators scrambling to comply. The law covers such areas as application procedures, hiring, firing, advancement, compensation, and training.

Source: Buck Consultants, Wall Street Journal

Beef And Chicken: What A Difference A Decade Makes

It's no surprise that American consumers have been gobbling up chicken in ever increasing amounts in recent years, and that beef and pork consumption is down. But Americans still consume more beef than chicken. However, consumption figures from the past 10 years shows that the difference is narrowing considerably.



Source: American Meat Institute, U.S. Dept. of Agriculture

Charts by Peter K. Niceberg

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Cover illustration by Robert Neubecker

Published monthly except semi-monthly in Jan., Mar., May, July, Sept., and Nov. by Restaurant Business Magazine, (ISSN 0097-8043), 633 Third Ave., New York, NY 10017. Vol. 91, No. 13. Second Class Postage paid at New York, NY, and additional office (USPS 917-180). Canadian Post International Publications Mail (Canadian Distribution) Sales Agreement No. 546275. Postmaster please send address changes to Restaurant Business, P.O. Box 3091, Southeastern PA 19398-3091.

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IN THE NEXT ISSUE

SPECIAL REPORT 25TH ANNUAL RESTAURANT GROWTH INDEX. This is the silver anniversary of our exclusive state-of-the-industry analysis. The RGI is an essential tool for evaluating the potential of industry and geographic segments. As in previous years, it is presented in two sections: reports on trends in the market segments and a comprehensive package of statistical tables grouped by Metro Areas and ADIs.

TEST KITCHEN SANDWICHES. Specialty breads, vegetable-based fillings, flavored sauces and spreads have all helped operators turn sandwiches into signatures. And with the help of high-quality convenience items, building better sandwiches has never been easier.

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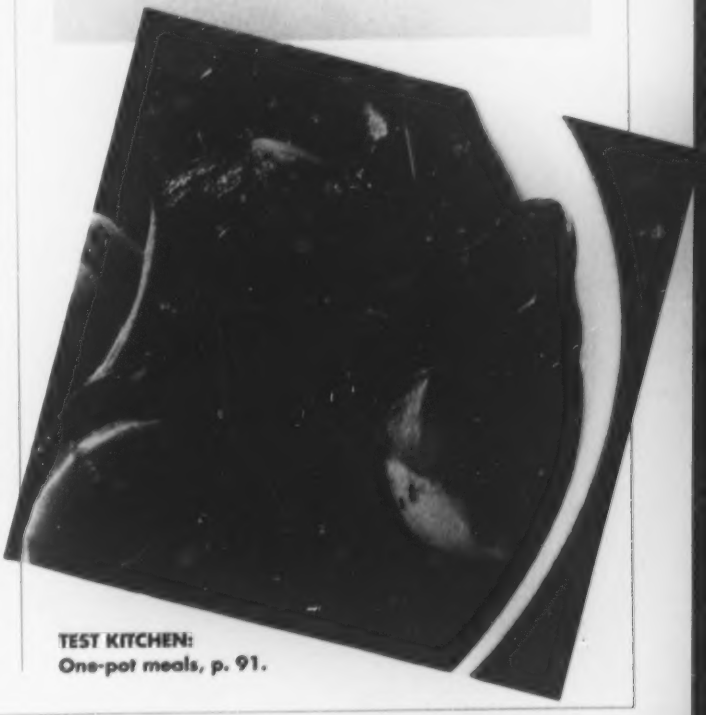
CHEF'S ART ANDREW SWERSKY. At the Morada Bar & Grille in Boca Raton, Fla.



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MAIL TO: RB Magazine
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RESTAURANT BUSINESS

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CONTRIBUTING EDITORS
Alexa Bell, Peter Berlinski, Mark Bittman, Steve Brooks, Carol Casper, Heidi Dawley, Keith Dunnavant, E.S. Ely, Don Nichols

COLUMNISTS
Dr. Joseph Durocher, David L. Epstein, Dr. Michael Kasavana, Gen LaGreca, Bill Main, Edmund Osterland

PRESIDENT/GROUP PUBLISHER
Jeffrey P. Berlind

Editorial Office
633 Third Ave., New York, NY 10017
(212) 984-2332

West Coast Office
10540 Talbert Ave., East Tower, Suite 150
Fountain Valley, CA 92708
(714) 964-6470

Midwest Office
180 N. Michigan Ave., Suite 1600
Chicago, IL 60601
(312) 782-1266

RESTAURANT BUSINESS Magazine (formerly FAST FOOD) (ISSN 0097-8043) is published monthly except semi-monthly in Jan., March, May, July, Sept., and Nov. by Bill Communications, Inc., 633 Third Ave., New York, NY 10017. Telephone: 212-986-4800.

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Subscriptions in the U.S. $79; Canada $114; foreign surface $124; airmail $212. Single copies in the U.S. and Canada, $7. Second class postage paid at New York, NY, and at additional offices. Postmaster: Please send address corrections to Restaurant Business, Post Office Box 3091, Southeastern PA 19398-3091

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gCaAmReDs

While the card companies brawl for market share, restaurateurs angle for a better deal

In a way it resembles the race for the White House, this contest of the plastic cards to win most-coveted slot in the wallets of America's diners and most-coveted spot on the tables of America's restaurants.

There is the incumbent, American Express, in power for years, portrayed by some constituents as arrogant and uncaring, trying mightily to stem a further economic downturn. It has of necessity become a kinder, gentler card company, making concessions it sneered at during the comfortable, cozy '80s it controlled.

And there is the opponent, Visa—with clone-like MasterCard tagging along as its unofficial running mate—energized by the call for change and basking in new-found popularity. Its focus: a broadened base of support. Its campaign strategy: to erode the incumbent's core constituency.

There are also lesser candidates involved in this grab for restaurant dollars: Diner's Club, barely scratching the market it invented; and the upstart Sears card, Discover, growing in public acceptance.

Who's going to win? It's too close to call. But one thing seems clear as Chardonnay: Restaurateurs are out to challenge the credit industry's old business-as-usual policies.

In the 1980s restaurant operators barely whimpered about taking 3% to 5% off their bottom lines for the care and feeding of the card companies. But with this decade's lingering recession, increased unemployment, and the cutbacks in corporate perks, America's restaurant owners are bellowing their demands for better service, lower rates, and a clearer appreciation for the fickle nature of foodservice.

"There's less of a bottom line to take away from now," says David Rea, of the Olde Towne Chop House in Fort Lauderdale. "There's higher insurance, higher workers' comp, the FICA tax on tips. Couple that with the fact that people are just not going out as much now. As the volume goes down, the card rates go up, so you're being penalized. In the face of a recession, it's just not fair."

"It's tougher and tougher to make money today," echoes John Buchanan, managing partner of The Original A-1 restaurant in Chicago. "Operators need to reduce expenses on all sides, and credit cards are part of that."

The card companies and the banks that issue the cards have been getting the message, despite the fact that they, too, are victims of the sour economy and falling interest rates. Fifteen percent of all card purchases are made in restaurants—by one estimate that will amount to almost $42 billion this year.

To support that 15% share, card companies have become leaner, meaner, and smarter about how they do business. Last year, AmEx lowered its rates for the first time since the late 1970s and aggressively touted its advertising support programs for its restaurant customers. The bankcards are out courting casual and low-priced restaurant operators big time, while hundreds of merchant banks are striking deals for lower rates.

The credit industry of the '90s "is going to be driven by the choices of the restaurant industry," says Discover's senior vice president of merchant sales, Michael Leavitt.

BY RON SYMPSON

ILLUSTRATION BY ROBERT NEUBECKER

AMERICAN EXPRESS
VISA
VISA

But don't think the restaurant industry is making all the choices, because clearly it is not. It is the credit industry that master-minded consumer demand for cashless transactions, obligating nearly 80% of U.S. restaurateurs to accept cards as a condition of doing business. Cards are no longer simply plastic status symbols for well-heeled businesspeople to flash at high-check dinner spots. They've become ubiquitous in the realm of casual dining, too. "We take about every [card] out there," says Red Lobster's Dick Monroe. The 555-store seafood chain accepts MasterCard, Visa, AmEx, Discover, and Diner's. So does its sister operation, the 345-unit Olive Garden.

PHOTOGRAPH BY ARTHUR POLLOCK

DiFillippo drew blood in Boston. A year later, AmEx is a kinder, gentler card.

Even fast-food restaurants are buckling under to the credit-card craze, through technology that makes charge approval as quick as a cash exchange. Already involved are most of the major chains, from Arby's and Taco Bell to Burger King and Grandy's.

Market segmentation aside, however, the battlefield on which most eyes are focused today is the same one in which the card games began—the upscale end of the restaurant business. It is there that the once supreme AmEx card is taking it on the chin.

The first volleys were fired in January 1991 when a handful of Boston restaurateurs threatened to boycott AmEx for refusing to lower its "discount fee"—the card companies' curious label for the percentage of a sale deducted for a charge transaction. The action soon escalated into a nationally publicized frenzy. By the time it was over, AmEx's travel related services division had taken a heavy hit, and its competitors rushed in to pour salt in the wounds.

Steve DiFillippo, who operates three Boston-area Davio's restaurants, was among the organizers of the protests. At the time, AmEx was assessing rates of 3.25% to 4.5% on restaurant charge sales.

"Everybody was lowering their rates, the garbage collectors, the linen service," says DiFillippo. "American Express was just one of those line items and we thought, 'Gee, why don't we get together and see if they can lower their rates?' We had a meeting with [AmEx], four or five of us. They kept saying the chairman sets the rates, there's nothing they could do. It was just incredibly arrogant. We independently decided we'd drop American Express."

After the third meeting, DiFillippo was pictured in a Boston newspaper driving a chef's knife through an AmEx card. The story was picked up nationally. "At one point there were a couple of hundred restaurants easily [participating]," he claims.

Saul Garlick, an accountant for 50 Boston restaurants, says the operators were able to strike a deal with a merchant bank for MasterCard and Visa to lower their rates from 2.75% to 1.7%, but that AmEx wouldn't budge. "Sales were off 5% to 15% in the Boston area then," Garlick explains. "They were cutting payrolls, going to purveyors asking for reduced fees, going down the line, cutting expenses everywhere they could. They were able to do it in every area except American Express. That's why the restaurateurs boycotted."

Patricia Duffy, vice president for restaurant marketing at AmEx, describes the revolt as her company's "call to action." But her recollection of events varies somewhat from the restaurateurs'. "They basically said to us, 'We are demanding that you drop your rates to us or we are going to cancel,' " Duffy says. "We

A Rate's A Rate, Except...

It is within the volatile arena of fee structures that the choices for restaurateurs become most muddled, and where new card games are constantly being dealt. Sure, you can shop cards for the best deal on the "discount" rate that the company charges on each transaction. But *caveat restaurateur* if you plan to negotiate by rate alone.

"Rate is a devious animal, because you don't really know what your rate is until you add it all up," says Katherine Oakes, director of associations for one of the nation's largest card processors, Inter-Banc Financial Network in Knoxville, Tenn. "It's like a phone bill."

The confusion stems from differences in cards, in the way they are issued, and in the way they are processed. And each layer of difference can carry cost implications for the operator.

Charge cards, such as American Express and Diner's Club, require payment in full on the account each month, and do not charge interest to the account holder. The companies' income is derived from annual card fees and its "discount rate" (a percentage the company deducts from each restaurant charge). Discount rates, which are directly collected by the company, tend to be higher for charge cards because there is no revenue from interest income. The discount rate for American Express ranges from 2.7% to 4.25%; Diners Club from 3.5% to 4%.

Credit cards, such as Visa, MasterCard, and Discover, do generate interest income from extending revolving credit. They offer the cardholder the option—for a fee—to carry an outstanding balance from month to month.

More importantly, Visa and MasterCard are controlled by associations (with overlapping memberships) of banks and a few corporations—most notably AT&T—that issue the cards to consumers. (Discover is issued through Sears Roebuck affiliate Dean Witter Financial Services.) Other member banks negotiate discount rates with restaurants to process their card transactions, and compensate the issuing institutions via an interchange rate, which is set by the association. In addition to a percentage of the restaurant credit sale, a per-transaction fee may be assessed. The difference between the discount rate which the processing bank quotes the restaurateur and the interchange rate paid to the issuer represents the processing bank's profit—and a target for negotiation by the retailer.

The interchange rate for Visa and MasterCard currently ranges from 1.25% with no transaction fee to 1.91%

explained that we are not going to just drop Boston's rates. It would have to be across the board. They said, 'You are an expense we need to reduce.' Our response was that there are two sides to your P&L statement. 'You want to focus on the expense side. Is there something we can do to help on the revenue side?' "

Negotiations deteriorated by the third meeting, Duffy says. "At that point the [news] coverage began and got things focused entirely on price. The largest [number of restaurateurs] we ever had was about eight. They said they had hundreds."

The upshot is that five months later, AmEx buckled under. It introduced new rates based on electronic processing that dropped the cost for restaurants doing $1 million a year or more in AmEx sales to 2.7%. And all but two or three Boston restaurants returned to the fold.

In the meantime, however, Visa and Discover moved into town. Discover sent in a sales force to woo the disenchanted restaurant owners. Within nine months, says Discover vice president Leavitt, the card's acceptance rate at Boston restaurants grew from 25% to 75%.

MasterCard stayed out of the fray. "It's always been our position not to get into a battle," says Ellen Alexander, vice

INTER-BANC'S OAKES: "You have some [banks] totally ripping accounts off."

PHOTOGRAPH BY CHARLES BROOKS

and a 10.6¢ fee per transaction. After the processing bank has figured in costs and profit, the discount rate can run to 2.3% or more.

The Visa board has set new interchange rates to take effect in April 1993. The range for credit cards will run from 1.25% to a high end fee of 2% plus 11¢ per transaction. For operators who use standard paper processing, that amounts to a rate hike of about 5% on a $50 check, assuming the processors don't take an increase of their own.

What's likely to come as more of a jolt to restaurant owners is that for the first time, Visa has established a sharply different interchange rate for accepting the company's corporate card, of which about one million are now in existence. According to the trade publication *Credit Card News*, the new interchange fee will be 1.98% plus 6¢ per transaction, up from a low-end of 1.4%. The bottom line increase for restaurateurs at the cheapest rate on Visa corporate cards will amount to 47%—from 70¢ to $1.03—on a $50 check.

A Visa spokesman declined to comment on the new interchange rates, except to acknowledge that separate fees had been established for corporate cards.

Charge or credit card, your discount rate will be affected by the annual volume of sales on the card, the average charge per card transaction, and the way in which the charge is processed—from the standard paper route to sophisticated computerized networking. Of these, says Inter-Banc's Oakes, the method of processing now bears the most weight on the size of a restaurant's discount fee.

At the high end of the rate schedule, she explains, is the standard paper credit card form for the restaurateur who simply "accepts the card and walks over to the bank and hopes it's good. They pay dearly for that, 4% or 5%."

The lowest rates are available for restaurants where credit processing is fully automated with a "draft capture environment." Charges are processed through a sophisticated computer network that tracks cardholder status and quickly updates the account. The result is significantly reduced bad debt.

Until last June, American Express based its discount fees solely on sales volume, with no compensation for electronic processing. Rates ranged from a low of 3.25% for restaurants charging at least $1 million in sales a year with AmEx, to a high of 4.5%.

Rates were cut last year after boycotting Boston restaurateurs put the company on a national hot seat. Currently, American Express discount fees are 3.25% to 4.25% for standard paper processing, and 2.7% to 3.98% for electronic processing.

The adjustment to an electronic rate category meant significant savings for high-volume operators. On a $50 check, the AmEx fee dropped 20%, from $1.63 to $1.35. For $1 million in American Express sales, that amounts to adding $5,500 to the bottom line.

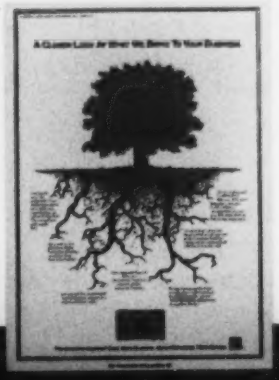
Electronic processing, however, doesn't come cheap. There are lease or purchase costs for system hardware—such as printers and terminals—installation, training, network access fees, and phone lines. Other costs above and beyond the quoted discount rate include application fees, deposits to be held against chargebacks, statement fees, supply costs, and fees paid to a third party broker offering the convenience of one-stop processing of multiple cards.

Which part is negotiable? All of it.

president of restaurant marketing. "I think service is the issue of the '90s."

During the Boston revolt, Visa's only active involvement was to pay for an attorney to help the activist restaurateurs avoid violating federal trade regulations in their threatened boycott.

But since then, Visa's bankcard association has taken AmEx head on: with a "profit improvement calculator" claiming huge savings with Visa; with a fiery ad campaign urging restaurateurs to red-pencil AmEx contracts to their liking; with point-of-purchase materials that clearly announce a restaurant's preference for Visa; and with a beefed-up business card for corporate clients.



Having now placed more credit cards in the wallets of consumers than all the other companies combined, Visa has shifted its approach from consumer saturation to the expansion of its markets.

"American Express has never had this competition before we came into the marketplace. They had a free rein," says Thomas Edwards, Visa's vice president of travel and entertainment marketing.

The most forceful of Visa's attacks is a two-page advertisement in restaurant trade magazines belittling AmEx's post-Boston rate reduction and deriding the company for contract clauses that forbid restaurateurs from voicing a preference for one card over another. The ad pictures a restaurant owner with a gag over his mouth.

"Remember, no one can force you to give up your freedom of speech, your freedom of movement, or your freedom to make your own business decisions," Visa admonishes, and then suggests: "Get out your red pencil. Cross out or change any part of the proposal that you see as an infringement on your rights."

Edwards defends the advertisement. "It's not a heavy-handed approach," he insists. "The merchants are aware if they don't red-pencil the contract it could be costing them valuable profits."

But credit-industry consultant Michael Auriemma questions Visa's efforts. "I'd like to see what happens when *they* get their first red-lined contract," he says.

AmEx's Duffy says Visa has distorted the intent of the AmEx contract.

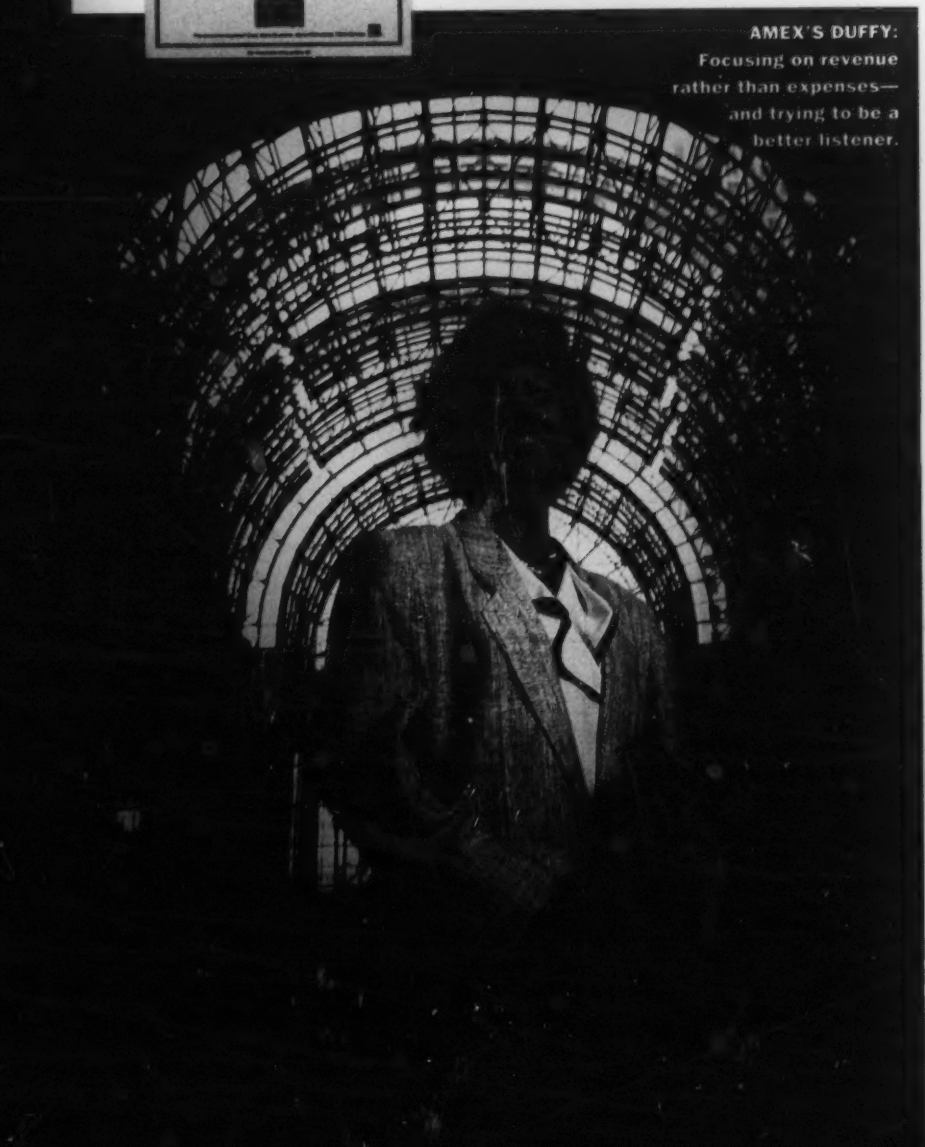
"Our contracts have always required equal treatment," she says. "We simply say you will not discourage use of our card." As to the suggestion that the contract be red-lined, Duffy comments: "That can't happen. We're not going to say that some restaurants can get rid of our equality treatment [clause] and that others can't."

Auriemma also contends that AmEx could drop its rates even further than it has, explaining that the income Visa and MasterCard banks make on revolving credit may not exceed 6% or 7% because of the interest the companies have to pay on the money they front to consumers. "The [Visa and AmEx] P&Ls are different, but not so lopsided as American Express would have you believe," he says.

Partially because of the rates, and partially because of what appears to be a general distaste among operators for AmEx, Chicago restaurateur John Buchanan tried a sort of boycott of his own. When he opened his restaurant in 1990 he decided not to accept the AmEx card.

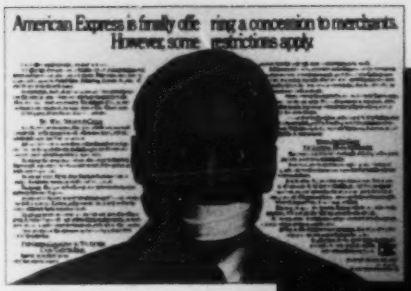
He quickly changed his tune. "Customers came in and said, 'What do you mean, you don't take American Express?' " Buchanan recalls. "I gave in after three months." AmEx now accounts for 40% of his charge sales.

AmEx bashing has evolved into somewhat of a sport among restaurant operators, but just how justified it is may be another matter. Sure, AmEx rates are higher than other cards, but other cards don't come with the same support. AmEx contributes to an operator's own advertising budget; its database



AMEX'S DUFFY: Focusing on revenue rather than expenses—and trying to be a better listener.

PHOTOGRAPH BY FRANK VERONSKY



research regarding customer trends and spending are second to none; and problem solving with business accounts is widely thought to be superior to others'.

On the consumer end, AmEx's billing methods provide cardholders with a more detailed breakdown of spending than other cards. "They provide their customer with more information than a bankcard does, so there must be more cost [to them]," says Garlick. "The consumer has a real preference for American Express and as a restaurateur you have to recognize that. It's just a better package."

Arturo Burigatto of The Vickers in suburban Philadelphia is among the AmEx bashers—"I wish I could get rid of the [card]," he says. He pays AmEx 3.65% on its charges compared to 1.67% for MasterCard and Visa.

At the same time, however, Burigatto acknowledges that AmEx does provide him with 60% of his card sales, and that he appreciates the marketing help and other support he gets from the company. And he isn't alone.

"They're still the best as far as problem solving and support," says Fort Lauderdale's Rea of AmEx. "You're dealing with one company, with one card, instead of hundreds of banks. They've become very aggressive with their co-op advertising and they have a nice rate. I went to a seminar they sponsored on direct marketing for $25. Anywhere else it would be a $300 or $400 seminar."

AmEx stresses its restaurant marketing support in the advertising it is currently running to counter Visa's ad campaign. AmEx dodges the rate and equality issues, leaning instead on such attributes as the heavy dining habits of its cardholders and the popularity of its business card among corporations.

It is in the business card category that Visa has launched its latest assault. The company claims to have enlisted scores of major corporations for the card and says its use has grown by 250% in the last year. Even so, Visa's estimated 1 million corporate card holders amount to only one-fifth of AmEx's.

And in what is likely to come as a shock to restaurateurs, Visa has set new fees for accepting its corporate card that amount to a 47% increase—in the case of restaurant owners now paying the lowest rate—on a $50 dinner check. The new fees, according to the industry newsletter *Credit Card News*, will take effect in April. Visa would neither confirm nor deny the new price structure.

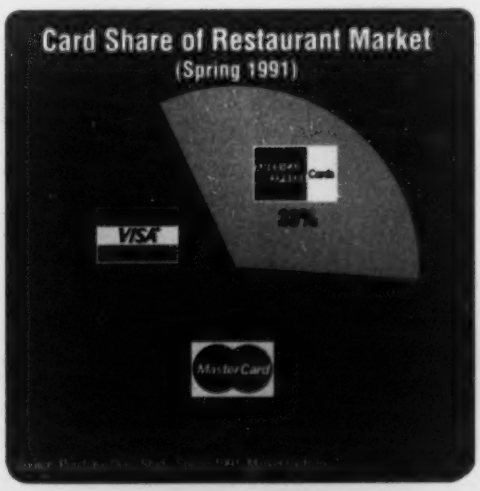
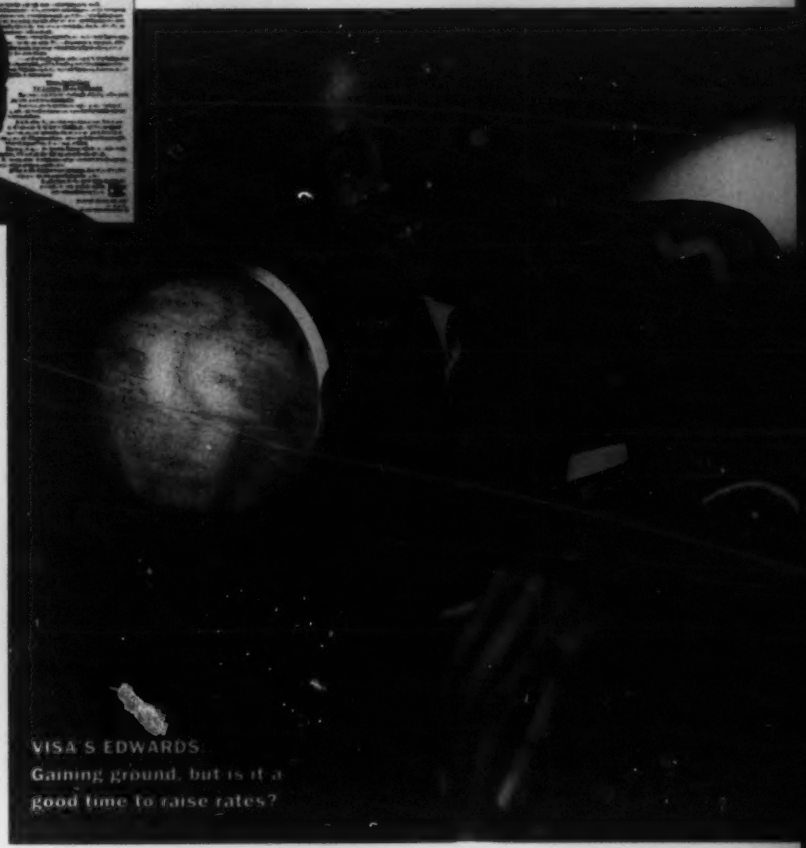


CHART BY PETER NICEBERG



VISA'S EDWARDS:
Gaining ground, but is it a good time to raise rates?

PHOTOGRAPH BY ROBERT HOLMGREN

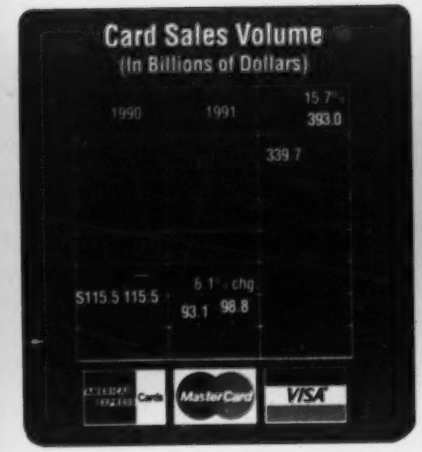
Reacting to Visa's plan, one card company executive, who spoke on condition of anonymity, described it as a "bait and switch" ploy—enticing restaurants to drop AmEx, then moving in with higher rates.

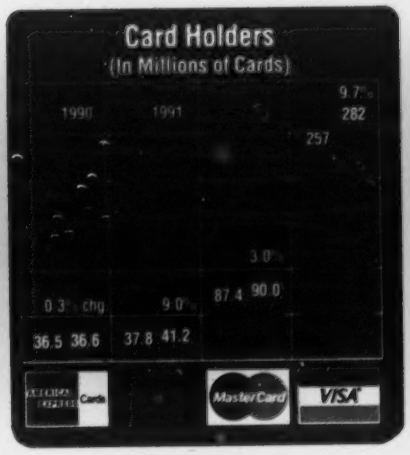
Katherine Oakes, director of associations for Inter-Banc Financial Network, one of the nation's largest credit card processors, says Visa is "looking at terrific accounting problems. It'll create a nightmare for the industry on all levels." She says the new rate will "become extremely expensive." When processing and bank charges are added to the new fee, she says, restaurateurs "could be looking at 2.5% plus 20¢ per transaction" on Visa corporate card charges.

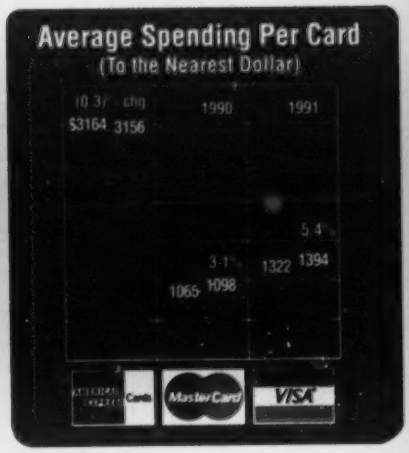
AmEx's Duffy says restaurant owners won't be fooled by Visa's corporate card game. "There are a lot of savvy people out there," she says. "They know their business."

So far, the combination of the Boston insurrection and the Visa campaign seems to have inflicted heavy damage. In the second quarter of this year, AmEx disclosed a 48.7% drop in income at its travel related services division—down to $123.9 million from $241.5 million the prior year. The company attributed the decline to increased promotional expenses.

The nosedive in divisional income







CHARTS BY PETER NICEBERG

rocked the entire corporation, leading to a 30.3% second quarter fall-off in the company's pretax operating income to $269 million from the previous year's $386 million. The report also showed a 4.8% increase in card billings from the previous year's quarter—up to $29 billion from $27.7 billion—but revealed that it had one million fewer charge cards in circulation than the 36.6 million cards at the end of 1991.

In contrast, Visa reported picking up an extra four million cardholders in the first quarter of this year for a total of 286 million. Card sales volume for the first quarter was $99 billion, which the company's Thomas Edwards says is an 11.5% increase over 1991.

The numbers make it appear likely that the 33%-29% restaurant market share edge AmEx held over Visa early last year has been trimmed.

AmEx is a long way from tossing in the towel, however. "Our approach to Visa is that we realize they're a very strong competitor and that they have a different product out there in many respects," explains AmEx's Duffy. "We're starting to see things come back."

EVERY LITTLE BIT HELPS
Rea's Olde Towne Chop House takes 8 cards.

PHOTOGRAPH BY BRIAN SMITH

Duffy points to a laundry list of services she distinguishes as unique to AmEx, including free-rein cooperative advertising based on a percentage of a restaurant's charge sales. "We've expanded the number of restaurants qualified for this support," she says.

Most important, Duffy says, is that AmEx has learned to be more responsive to the criticism of restaurateurs. "I know that there are still customers out there who are not happy, who are still trying to get the relationship in the right place," she says. "Listening is my mind-set for research."

AmEx has succeeded in its goal, as far as Fort Lauderdale's Rea is concerned. "There was a time when they could have told us to take a flying leap, but they realize that time has come and gone," Rea says. He pays AmEx 3.5%, plus a 15¢ per-transaction fee to a broker. Diner's Club and Carte Blanche get 3.75%, MasterCard and Visa charge him 2.29%, and Discover levies 2%. AmEx, however, accounts for most of his charge business.

David Guglielmo, treasurer for Commander's Palace in New Orleans and five other restaurants in Louisiana and Texas, somewhat grudgingly admits that AmEx brings in most of his charge business, too—about 56%. His restaurants pay below-average fees for AmEx, 2.7%; and for MasterCard and Visa, 1.55%.

He seems pleased with Visa's incursion into the upscale market. "American Express has been very good to the restaurant industry. The restaurant industry has been even better to American Express."

Boston restaurateur DiFillippo says he's encouraged by AmEx's change in attitude. "They're going out of their way to help us out here. I'm really proud of that." He says Boston's revolt against AmEx last year helped grease the wheel for the company's newfound openness.

But he's also excited about Visa's aggressive campaign in the upscale market, and looks forward to its intensified efforts to cut into AmEx's domination of the corporate card market. "You read the new ad?" he asks. "It's serious. It's a war."

But this is a war in which restaurant operators may be the principal casualties. One card company reduces its rates, another company raises them. Americans cut back on dining out and restaurant sales decline. "I don't see it getting much better," says DiFillippo. "I'm really nervous about the next couple of years." RB

BAKERY

MARKET SEGMENT REPORT

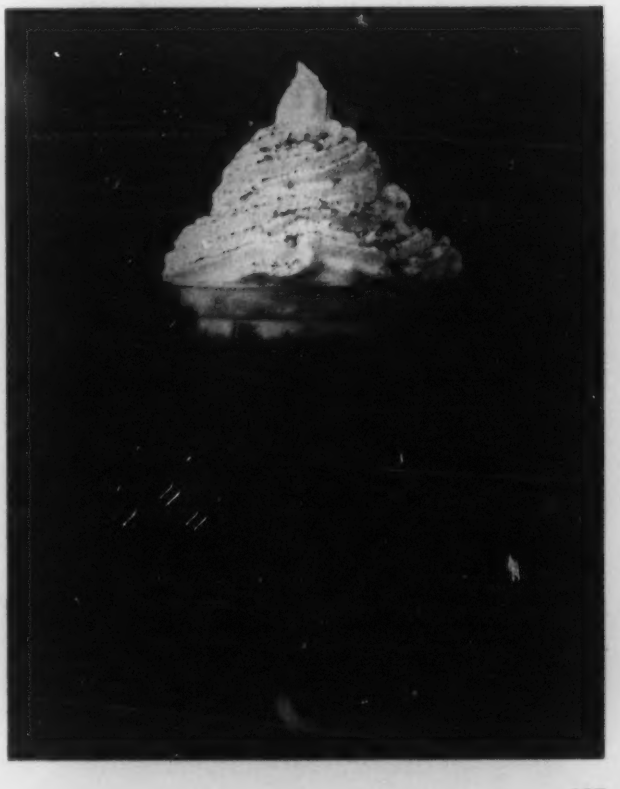
Operators are learning that more attention to fresh-baked breads and rolls is paying off.

By Carol Casper

The bakery segment defies easy categorization. With many restaurants opening their own bakeshops, independent retail bakeries selling snacks and sandwiches, and supermarkets battling on all fronts, the line seems to keep blurring ever further between foodservice, wholesale, and retail.

A couple of things remain clear, however. People find it difficult to resist the aroma of fresh baked goods straight out of the oven. Whether the setting is a restaurant serving its own homemade bread and desserts or a snack shop selling cookies or donuts, oven-fresh product holds tremendous appeal. Dessert sales have not diminished noticeably, but even more dramatic changes are taking place at the other end of the meal—in bread service. Operators are learning that greater attention to fresh-baked breads and rolls pays off in customer satisfaction and increased traffic.

Many retail bakeries in recent years shifted their focus away from breads, due to their low return on investment, and concentrated on more profitable sweet goods like pastries, *Bakery Production and Marketing* magazine points out. The editors suggest bakers should work on marketing a new category of value-added bread items—namely, sandwiches. Thus, restaurants may see more competition from retail bakeries on top of already growing competition from supermarkets and convenience stores.



Some companies are adding signature drinks like this Mochalatta Chill from Cinnabon.

Some bakeries have added eat-in sections, and more will do so, *BP&M* predicts. This trend converges on the restaurant side with the development of bakery/cafe chains like Au Bon Pain, which augment foodservice business with retail sales.

"We're offering customers a fresh, healthier alternative to fast food," comments Michael Simpson, president of Michel's Bakery & Cafe, a Midwest-based chain.

THE LEADER. With $1.2 billion sales in 1991 and more than 3,200 stores worldwide, Randolph, Mass.-based Dunkin' Donuts must be considered the uncontested leader of this segment. Dunkin' Donuts' strategy in recent years has been to broaden its appeal with products ranging from sandwiches on fresh-baked kaiser rolls to croissants and soup and sandwich combos. In the last year, however, the chain seems to be de-emphasizing efforts to go head-to-head against other fast-food concepts, according to Philip Bennett, vice president, corporate development.

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Thus, this year the chain has focused on its new line of Mini Donuts. The introduction has been highly successful say company officials, as well as judging by the number of other donut chains that have followed with their own minis.

Another major focus for the company is alternative channels of distribution to augment traditional store sales. Dunkin' Donuts' branded distribution outlets now include over 3,000 convenience stores and more than 500 institutional sites. Dunkin' also offers franchisees who operate at least one full-size store opportunities to expand through non-producing, scaled-down freestanding units and strip mall stores, as well as modular cart systems and product towers.

Dunkin' added approximately 400 new stores in '91, more than half outside the U.S. A growing number of freestanding stores are being built with drive-thrus.

Dunkin' Donuts also enlarged its franchised system through conversions of former Mister Donut stores. The chain, which was acquired by Dunkin' parent Allied-Lyons PLC in early 1990, continues to operate separately, while franchisees who qualify can elect to convert. So far about 175 of Mister Donut's original 500 units have made the switch, and more are expected.

With Mister Donut no longer expanding, and another major competitor, Winchell's, undergoing reorganization, Dunkin's dominance of the donut category appears stronger than ever.

In early 1991, Winchell's, La Mirada, Calif., announced that most of its 500-plus stores would be converted to a new concept called Winchell's 'N' More. Several units were built in 1990, featuring an expanded menu with sandwiches and frozen yogurt. Since then the chain has acquired a new top management team. According to a company spokesperson, the new general manager Nancy Parker "is formulating Winchell's strategic business plan for the '90s. A strong focus will be placed on Winchell's core business and expanding it."

From the perspective of Woodland Hills, Calif.-based Donut Inn, these developments have left a void in the donut franchising market, which it hopes to fill. Donut Inn's system presently includes only about 50 producing stores in California, all franchised. It expects to expand that number over the next 18 months. Donut Inn also markets its products through franchised satellite shops and alternative branded distribution outlets. Together these avenues add up to an additional 100 points of sale.

"We've dramatically increased our branded products program in the last year," says vice president of marketing, Stephen Blum. Recent additions include several contract feeders, plus c-stores and supermarkets. Donut Inn continues to diversify product offerings, but is committed to staying firmly within the bakery category. "We think items like sandwiches, soups, and frozen yogurt are too far afield," Blum says.

Scones were introduced this year and the cookie line was expanded. Other featured products include muffins, pastries, bagels, and plain and stuffed croissants. "Our emphasis is on developing more products for the breakfast segment," Blum adds. Donut Inn also recently added specialty coffees; some stores feature cappuccino and espresso bars.

Donut Inn's same-store sales rose 20% last year, says Blum.

SURVIVING NICHES. No other baked item appears ready to dislodge the donut from its leadership role in Americans' snack pantheon. However, several other specialty bakery operations have succeeded in carving out a niche. This has not been won without much struggle and significant casualties. Cookie shops and cinnamon roll stores, hot concepts in the '80s, have undergone a tremendous shake-out. A few strong players are still standing. Muffin shops, on the other hand, have achieved decidedly less success. Most chains have folded and none have achieved national recognition.

"Our biggest concern is the declining number of people shopping in malls," says Richard Dragonette, director of marketing for Original Cookie Co., Cleveland, Ohio. "We have to respond by finding other channels of distribution, and/or increasing our 'strike rate' among the customers that do still come."

These pressures have led some to diversify product lines. Others have retooled their concepts to become destination operations.

One operator that has remained successful by sticking to its original formula is Seattle-based Cinnabon. A subsidiary of Restaurants Unlimited, Cinnabon is the largest purveyor of fresh-baked cinnamon rolls, with 168 stores in 29 states and four in Canada. About 100 are franchised.

The chain opened 20 stores in the last 12 months, and expects another 10 to 15 to open before year's end. It projects systemwide sales of $65 million for '92, up from a little over $50 million last year.

Most stores are in malls. It also operates a few in downtown storefront locations near offices, and one at the Detroit

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Segment	1991 Units	1991 Sales (Billions)	1992 (estimate) Units	1992 (estimate) Sales (Billions)
Retail	21,886* (1)	$7.1	21,287* (1)	$7.5
In-Store	23,280	$8.1	23,725	$8.6
Wholesale	2,636	$23.1 (2)	2,646	$23.4 (2)
Foodservice	288,939 (3)	$5.8*	297,889* (3)	$6.7*
Total Sales		$53.1		$55.2

Notes: (1) Individual retail units
(2) Wholesale includes bread/cake, cookie/cracker, and frozen bakery
(3) Projected number of foodservice units baking on-premise or receiving product from dedicated commissaries
* Revised estimate

SOURCE: Bakery Production and Marketing, U.S. Commerce Dept., Food Marketing Institute, National Restaurant Association

CHART BY SHARI FANG

BAKERY

MARKET SEGMENT REPORT

Metro airport. "We're continuing to look at alternative sites," says director of marketing Gary Merritt. Cinnabon opened a test unit in Smitty's supermarket food court in Scottsdale, Ariz.

Although it once eclipsed Cinnabon with more than 200 units, T.J. Cinnamons, Kansas City, Mo., has suffered setbacks in recent years, and ended '91 with a total of 132 stores, mostly franchised. President and CEO William Teel, however, thinks the chain's period of closings is behind it. "The recession has hurt everyone, but we are in a pretty good position because we already went through our own company recession and restructuring two years ago."

Teel attributes some of the difficulties to a lack of selectivity in sites during its quick growth years. T.J. Cinnamons developed both strip center and mall units, but expects to concentrate primarily now on mall locations. The company also has one supermarket bakery unit, and is exploring possibilities in emerging supermarket food courts.

In contrast to Cinnabon, T.J. Cinnamons offers a broadened line that also includes muffins, cookies, croissants, and bagels. Its signature cinnamon rolls still account for more than 50% of sales.

Same-store sales were roughly flat last year, but have shown some improvement so far in '92, Teel adds. The chain ended '91 with systemwide sales slightly below $30 million.

Another cinnamon roll purveyor still hanging on is Cindy's Cinnamon Rolls, Fallbrook, Calif. Down to 38 stores today from over 50 three years ago, it plans to start growing again. "Currently we're targeting five new stores a year, says president Tom Harris.

All Cindy's units are in major regional malls. Even though mall traffic is down and same-store sales were off 3% in the last 12 months, Harris still believes malls represent its best bet for future growth.

A few cookie chains, too, have achieved national success, by focusing on basics. However, the list of those that have disappeared is far longer.

The diversification of Il Fornaio ranges from bakeries to Italian restaurants.

Two that appear solid are The Original Great American Chocolate Chip Cookie Co., Atlanta, and Original Cookie Co., owned by Paris-based Midial, which also owns Fanny Farmer.

"We've done fine in the last 12 months," says Erik Gordon, COO of the former. "We've read all the scary news, but our sales numbers tell a different story. We think the issue is not so much mall traffic being down, but what people buy when they get here."

Gordon says same-store sales are up by single-digit figures. Great American operates more than 300 units, two-thirds franchised. It expects to continue growing at a rate of about 10% a year. The firm has made no major effort to explore alternative sites, but has developed a new kiosk-style outlet to supplement its 600-sq.-ft., in-line mall stores.

Original Cookie is something of an anomaly in the baked snack business, in that all its stores are company-owned. Growth slowed over the past two years, due partly to the closing of some weaker locations. The company had 250 stores open at the beginning of '91 and expects to have 260 by the end of this year.

"Last year was difficult for everyone, and we scaled back our plans accordingly. However, we expect to return to average growth of 10 to 12 stores annually next year," Dragonette comments. Despite reduced openings, Original Cookie still increased systemwide sales nearly 7% in 1991, to $64 million.

Original Cookie stores offer three basic categories: bite-size, large old-fashioned, and gourmet. "We're also putting more emphasis on our 13-in. personalized cookies," says Dragonette. Original Cookie also sells "Cookie Cups," cookie shells baked in muffin tins with fillings.

Although still on the scene, Mrs. Fields Cookies has not been very active in the last couple of years. It once led development of the segment, but is now believed to be in financial trouble and perhaps planning a change in direction.

Officials of the Park City, Utah-based company declined to divulge plans, but competitors and industry observers speculate that the company has shifted its interest from cookie stores to cafes and licensing agreements. Mrs. Fields operates 700 cookie stores plus 100 La Petite Boulangeries bakery/cafes and about 20 Mrs. Fields Bakeries.

It signed a licensing agreement last year with TCBY Enterprises allowing the yogurt chain to market its cookies as well. About 200 TCBY units now offer them. Mrs. Fields is reportedly pursuing

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Some single-concept chains have achieved success by focusing on basics.

BAKERY

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licensing agreements with other companies. Future developments will be up to Debbi Fields, who took over from Randy Fields as chairman, president, and CEO.

In the last few years, the market has become ripe with opportunities for branded product distribution, without the need of a system of stores, asserts Steven Stein of Specialty Foods Management, New York, which manufactures David's Cookies. A remnant of the former David's Cookies stores still operate under independent ownership, forming a key customer base for Specialty Foods. It provides David's Cookies in both frozen dough form and as prebaked, packaged product to them and a growing network of other retail stores, supermarket bakeries, restaurants, and contract feeders.

While such licensing and alternative distribution channels represent one survival strategy for hard-pressed bakery specialists, diversification is a possibility.

Bakery/cafes are one of the hot new niches in restaurant development.

Another specialty chain, Cookie Factory, Oak Brook Terrace, Ill., expanded its lines under the new name Cookie Factory Bakeries several years ago. After experimenting with limited lunch menus, this chain is now an expanded bakery concept, still primarily based in malls. Meanwhile, president Michael Simpson is pursuing opportunities with Michel's Bakery & Cafe.

There are currently 37 Cookie Factory Bakeries, and seven Michel's—all but three are franchised—operating in 15 Midwest states. Simpson projects six to 10 units, between both concepts, will open over the next 12 months.

Sales for the bakery/cafes typically run from $300,000 to $500,000 annually, while the Cookie Factory Bakeries average about $330,000.

Another specialty baker going the restaurant route is Mrs. Powell's Delicious Cinnamon Rolls, Boston. In the course of several ownership changes, Mrs. Powell's has evolved from cinnamon roll purveyor to deli/bakery. Since taking over in January, new president Ron Blane, a Dunkin' Donuts veteran, has steered the chain toward deli business and territory licensing. The company debuted its first combination deli/bakery unit in downtown Boston last spring and expects its first two franchisees to open four more by year's end.

New stores will also offer a limited selection of deli sandwiches priced under $4. Another signature item is a "muffin top." "It allows us to offer a unique product with the same appeal as a muffin, but in a more convenient size and shape similar to that of a cookie," Blane says.

Wherever mall leases allow, Mrs. Powell's existing 46 stores will be converted to the new deli concept. Some of these began adding soups, salads, and sandwiches last year to attract lunch business, plus new breakfast items like bagels and scones.

INSPIRATION. Many of the new bakery/cafe operators have no doubt been inspired by the success of Boston-based Au Bon Pain, which continues to solidify its position as the leader of this niche. The chain finished '91 with 107 units, up from 86 in 1990. In '92 it plans to open 31 more, including six franchised sites. This will maintain its ratio of about 80% company-owned stores.

In addition, the firm recently signed an agreement to acquire Warburton's English Bakery Group, a 22-unit "English-style" bakery/cafe chain based in Chicago. Most will be converted to Au Bon Pain units.

Au Bon Pain's sales in '91 hit $80 million. Exclusive of the Warburton acquisition, they are expected to top $110 million in '92, says vice chairman, CEO Louis Kane. "Our same-store sales are up 6%-8% across the system," he adds.

The company has helped fuel growth with two public stock offerings. Between them, Au Bon Pain raised close to $50 million to retire its debt and fund further development.

Au Bon Pain significantly expanded its menu to include salads, soups, and sandwich selections. All baked products are prepared from frozen dough supplied by its own central production facility.

Another company that has turned European-style baked goods into good business is Il Fornaio America Corp., San Francisco. Since chairman and CEO Larry Mindel took over the struggling

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Au Bon Pain expanded its menu to include salad, soup, and sandwich selections.

chain of Italian bakeries in 1986, it has grown into a diversified company that combines wholesale bakery operations, retail sales, bakery/cafes, and full-service Italian restaurants. Last summer, the company debuted its newest blended concept, Il Fornaio Cucina Expressa.

The first Cucina Expressa, in Costa Mesa, Calif., provides self-serve counter-service in surroundings that include colorful food displays, indoor and garden seating, and tray counters, tabletops, and floors made of European limestone, plus ovens and cooking island in full view. Offerings include wood-fired rotisserie chicken, pastas, soups, and salads, all moderately priced. It also offers grilled panini and tosti (regular and toasted sandwiches). Breakfast includes a wide selection of breads and pastries, plus heartier items like Italian-style egg dishes and homemade cereals.

Last summer the company opened a new Panificio (wholesale bakery) in Pasadena. The site will be completed early next year with the addition of a full-service Cucina Italiana restaurant, gelateria, and retail bakery. Another new project will open at San Jose's Hotel St. Clair this fall. There Il Fornaio will operate a hotel restaurant, retail store, and handle all hotel foodservice.

Despite the spotlight on baked goods, according to *Bakery Production & Marketing's* "Trends '92" analysis, the number of foodservice operations doing their own baking on-premise is on the wane. More operators are turning to wholesalers to supply their needs.

However, an opposite trend seems to be occurring among family restaurants and moderate check or casual/upscale places, many more of whom have been moving bakery operations to the front of the house. The trend is strongest in the family steakhouse category, where it was pioneered a couple of years ago by Golden Corral, Raleigh, N.C., in some of its "Metro Market" units. Most of these larger operations now have Brass Bell Bakeries, and the 450-unit chain is starting to add them to some smaller restaurants as well. The display bakeries, which ring a bell every 10-15 minutes as fresh product comes out of the oven, have become a focal point.

WSMP's Western Steer restaurants are also adding display bakeries. Over a dozen locations now have them, and 42 more of its 132 units are due to be retrofitted by the end of the year. In this effort, the Claremont, N.C.-based chain is benefitting from the experience of WSMP's Mom'n'Pop's Bakery Division, a national retail supplier which is helping with the development of their on-premise bakeries.

Western Steer is adding Mom'n'Pop's Bakeries.

Ryan's Family Steak Houses, Inc., Greer, S.C., and Sirloin Stockade International, Hutchinson, Kan., are two of the most recent family steakhouse chains to jump on the bandwagon. The bakeries are effective image-builders for the economy steakhouses.

"The bakery adds a halo of freshness to everything in the restaurant," says Stephen Fortlouis, Golden Corral director of marketing.

Particularly in the Southeast, some operators of upscale establishments have recently launched their own bakeries. Last year Buckhead Life Restaurant Group, Atlanta, opened the Buckhead Bread Company adjacent to its new restaurant, Pricci. BBC was developed to supply Pricci and Buckhead's five other restaurants, but it also serves other wholesale and retail customers.

After just a year of operation, the successful bakery is now moving to larger quarters and expanding to add European-style cafe service as well. The menu will include salads, soups, and gourmet coffees, as well as creative sandwiches, pastries, and specialty cakes.

Similarly, George Stathakis, owner of Stax's Peppermill, Stax's Grill, and Stax's Omega Diner in Greenville, S.C., opened Stax's International Bakery three years ago to supply breads, desserts, and croutons to his restaurants.

"Baking is a difficult way to make a living. If I could have gotten what I needed from local suppliers, I never would have started the bakery," says Stathakis. Business has been so good that Stathakis opened a second location this year.

Chicago-based Lettuce Entertain You Enterprises, Inc., also got into the bakery business when it opened the Corner Bakery in Chicago adjacent to an Italian concept, Maggiano's Little Italy. "We bake 20 different kinds of breads almost every day, plus cookies and muffins," says managing partner Jennifer Smith.

The Corner Bakery supplies several other LEYE concepts as well as wholesale accounts and retail customers. The store also does a lively eat-in and take-out breakfast and lunch business.

"We were confident in the operation, but the response has been better than we expected, and we're talking about another bakery now," says Smith. RB

"Freshness" is the watchword and one of the prime attractions of this category.